

CPI's Europe Column Presents:

Troubling Aspects of the European Commission's Standard-Essential Patents Roadmap

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(Global Antitrust Institute)

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In April 2017, the European Commission (EC) issued a consultation on its Communication on Standard Essential Patents for a European Digitalised Economy (the Communication).¹ As the Global Antitrust Institute at Scalia Law School at George Mason University noted in its comment to the EC, there are two main troubling aspects of the Communication:

1. The Communication appears to view variation in intellectual property rights (IPR) policies among standard-development organizations (SDOs) as a potential problem that may benefit from best practice recommendations.
2. The Communication refers to the need for “better regulation,” without providing evidence of an identifiable market imperfection, which is a necessary but not sufficient basis for economic regulation.

Embracing the Procompetitive Benefits of Variation Among SDO Policies

SDOs “vary widely in size, formality, organization and scope,”² and therefore individual SDOs may need to adopt different approaches to meet the specific needs of their members. Although uniformity of SDO IPR policies may have some benefits, it also has potential costs, including the difficulties of keeping up with fast-moving technology without knowing how well particular best practices will function.³ Indeed, uniformity is generally ill-suited to deal with dynamic sectors such as 5G technology. “The basic problem is that it [uniformity] proceeds by punctuated equilibrium rather than gradual evolution.”⁴ In other words, if evolving circumstances dictate a need for change, the EC may or may not be aware of that and may or may not decide to expend its limited resources on making the necessary changes to its best practices.

In addition, the costs of stifling continued experimentation and variation may outweigh the benefits of uniformity.⁵ Such costs may include halting the evolution of SDO IPR Policies. Empirical evidence shows that the IPR policies of SDOs vary both across organizations and over time in response to changes in the perceived risk of patent holdup and other factors as they arise.⁶ “A

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¹ Consultation at https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-1906931_en.

² U.S. DEP’T OF JUSTICE AND FED. TRADE COMM’N, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (2007) at 33 n.5, <http://www.ftc.gov/sites/default/files/documents/reports/antitrust-enforcement-and-intellectual-property-rights-promoting-innovation-and-competition-report.s.department-justice-and-federal-trade-commission/p040101promotinginnovationandcompetitionrpt0704.pdf> [hereinafter DOJ-FTC 2007 IP Report].

³ Bruce H. Kobayashi & Larry E. Ribstein, *Uniformity, Choice of Law and Software Sales*, 8 GEO. MASON L.R. 261, 275 (1999-2000).

⁴ *Id.*

⁵ *Id.* at 276.

⁶ See, e.g., Joanna Tsai & Joshua D. Wright, *Standard Setting, Intellectual Property Rights, and the Role of Antitrust in Regulating Incomplete Contracts*, 80 ANTITRUST L.J. 157 (2015). See also Joshua D. Wright, Comm’r, FED. TRADE COMM’N, Remarks Before George Mason University School of Law: SSOs, FRAND, and Antitrust: Lessons Learned from the Economics of Incomplete Contracts 2-3 (Sept. 12, 2013) (“[T]he economics of hold-up began not as an effort to explain contract failure, but as an effort to explain real world contract terms, performance, and enforcement decisions starting with the fundamental premise that contracts are necessarily incomplete. The incompleteness of contracts did not signal inefficiency; rather, incomplete

decentralized decision-making process normally can produce more possible solutions to a problem than could a single rulemaker.”⁷ As a result, innovation and experimentation through a decentralized SDO IPR Policy making may produce at least some IPR policies that are better than what a single uniform body could write. “This argument for nonuniformity may apply even if the benefits of uniformity appear to outweigh the costs in a particular context. Without advance knowledge of the discoveries this process would produce, it is impossible to determine ex ante whether competition among unknown alternatives will produce more efficient results than the centralized rule.”⁸

Another problem with uniformity is that “even the most perfect human drafting process cannot make objectively ‘right’ decisions. Two general problems infect any single uniform or model [best practices] in this regard.”⁹ First, the collective wisdom of hundreds or more drafting committees must be far greater than that of one uniform drafting organization. This wisdom is not only brought to bear on policy choices that are evident at the outset, but can lead to the discovery of new alternatives that could not have been anticipated at the beginning of the process by one person or organization. “A second reason why an evolutionary process is superior to a single uniform rule [or set of best practices] is that even the best drafter can design a statute [or best practice] only to suit the general conditions that exist at the time the statute [or best practice] is drafted.”¹⁰

In addition, issuance of best practices by a government agency may unduly influence private SDOs and their members to adopt policies that might not otherwise gain consensus support within a particular SDO and that may not best meet the needs of that SDO, its members, and the public. This could occur because the SDO believes failing to adopt the specified best practices is not permitted or because failing to adopt the best practices could subject the SDO and its members to other legal liabilities. Accordingly, the U.S. Antitrust Agencies have taken the position that they do “not advocate that [SDOs] adopt any specific disclosure or licensing policy, and the Agencies do not suggest that any specific disclosure or licensing policy is required.”¹¹

Indeed, when the U.S. Department of Justice’s Antitrust Division departed from its own position and offered recommendations for SDOs that were ultimately adopted in large part by the Institute of Electrical and Electronics Engineers(IEEE),¹² there is evidence of a decline in the

contracts were a predictable and efficient result given the costs associated with identifying all contingencies that might arise during the life of the contractual relationship.”), https://www.ftc.gov/sites/default/files/documents/public_statements/ssos-frand-and-antitrust-lessons-economics-incomplete-contracts/130912cpip.pdf

⁷ Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25:1 J. LEGAL STUDIES 131, 140 (1996).

⁸ *Id.* at 141.

⁹ Larry E. Ribstein & Bruce H. Kobayashi, *Uniform Laws, Model Laws and Limited Liability Companies*, 66 U. COLO. L.REV. 947, 951 (1994-95).

¹⁰ *Id.* at 952.

¹¹ DOJ-FTC 2007 IP Report, *supra* note 2, at 48.

¹² The IEEE’s 2015 revisions included provisions that essentially prohibit patent holders from seeking or enforcing injunctive relief on FRAND-assured SEPs and essentially require component-level licensing, the latter of which is contrary to the long-standing industry practice of end-user device licensing. The 2015 revisions also prohibit licensors from demanding licenses to applicants’ patents that are not essential to the same standard and from forcing an applicant to take a license to patent claims that are not essential to the referenced standard. IEEE-SA Standards Bd. By-

number of letters of assurances (LOAs) following the IEEE's 2015 IPR Policy changes, with numerous major standard-essential patent (SEP) holders explicitly stating that they were refusing to grant LOAs under the new policy due to the unbalanced nature of the revisions.¹³ In addition, IEEE meeting minutes report a slowed rate of development for 802.11ah following the 2015 policy changes.¹⁴

In my experience, agencies are particularly ill-equipped to offer best practice recommendations on issues such as “transparency on SEP exposure” or “core valuation principles,” issues that are instead best left to the market or, as a last resort, to the courts in those limited cases when the parties cannot reach agreement.¹⁵ Government recommendations may hamper market experimentation that could lead to even better IPR policy rules than could be foreseen at this time, and that also reflect variability in the marketplace.

Exercising Caution Prior to Disrupting the Carefully-Balanced FRAND Ecosystem

With respect to 5G in particular (which is the focus of the Communication), we see in the smartphone market, which is both standard and patent intensive, exponential output growth, falling market concentration, and a decrease in wireless service prices relative to the overall consumer price index (CPI).¹⁶ These indicators, although not proof of causation, do suggest caution prior to

Laws (2015), http://standards.ieee.org/develop/policies/bylaws/sb_bylaws.pdf
[http://web.archive.org/web/20150215104636/http://standards.ieee.org/develop/policies/bylaws/sb_bylaws.pdf].

¹³ Ron D. Katznelson, Presentation at IEEE GLOBECOM 2015: Decline in Non-Duplicate Licensing Letters of Assurance (LOAs) from Product/System Companies for IEEE Standards (updated Mar. 30, 2016), <https://works.bepress.com/rkatznelson/80/> (noting the decline in letters of assurance under new IEEE patent policy); Letter from Lawrence F. Shay, Exec. Vice President of Intellectual Prop., InterDigital, Inc., to David Law, Patent Comm. Chair, IEEE-SA Standards Bd. (Mar. 24, 2015), <http://wpuploads.interdigital.com.s3.amazonaws.com/uploads/2015/03/Letter-to-IEEE-SA-PatCom.pdf> (“InterDigital will not make licensing assurances under the new policy; and will instead make alternative licensing assurances, on a case-by-case basis, that are consistent with the goals of driving technology adoption while ensuring fair compensation for research success.”); Letter from Gustav Brismark, Vice President, Strategy & Portfolio Mgmt., Ericsson AB, to Eileen M. Lach, Gen. Counsel & Chief Compliance Officer, IEEE (Oct. 21, 2014), http://www.mlex.com/Attachments/2015-10-26_5P338037F7HPVP5L/and-terms.pdf (“Consequently, it appears that, moving forward, Ericsson would not be able to submit any [Letters of Assurance] under the terms of the proposed new IEEE-SA policy.”); Letter from Irwin Mark Jacobs, Founding Chairman & CEO Emeritus, Qualcomm, to Dr. Roberto Boisson de Marca, President & CEO, IEEE (Nov. 19, 2014), <http://www.advancingengineering.org/irwin-jacobs>.

¹⁴ See IEEE Meeting Minutes, “Discussion of the impact of updated patent policy on IEEE 802” at 4-5 (Jan. 2016) (reporting “delay in progress of 802.11ah, 4-6 months;” a change in “the dynamic on how people collaborate on new technology development” with IPR now a “major consideration;” “loss of momentum for 802.11ah” due to the IEEE’s 2015 IPR Policy changes; and “delay and chaos in 802.11ah as the engineers involved are not trained in these areas”), http://ieee802.org/minutes/2016_01/2016-01-22-minutes-v1.pdf.

¹⁵ For a discussion of the difficulties of court-determined rate setting, see Anne Layne-Farrar & Koren W. Wong-Ervin, *Methodologies For Calculating FRAND Damages*, LAW360 (Oct. 8-10, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2668623 and Anne Layne-Farrar & Koren W. Wong-Ervin, *An Analysis of the Federal Circuit’s Decision in Ericsson v. D-Link*, CPI ANTITRUST CHRONICLE, (Mar. 2015) at 4-5, <http://www.crai.com/sites/default/files/publications/An-Analysis-of-the-Federal-Circuits-Decision-in-Ericsson-v-D-Link.pdf>. In the United States, to determine patent damages, courts consider evidence of market factors that the negotiating parties would consider in determining the royalty rate. Often comparable licenses are the best available evidence of the market value of the patent. Accordingly, the U.S. Court of Appeals for the Federal Circuit recently held in *Ericsson v. D-Link* that evidence about comparable licenses based upon the end product should properly be considered by the jury in determining patent damages. The court reasoned that “[m]aking real world, relevant licenses inadmissible ... would often make it impossible for a patentee to resort to license-based evidence.” 773 F.3d 1201, 1235 (Fed. Cir. 2014).

¹⁶ According to data from Gartner, worldwide smartphone sales to end-users have increased over 900 percent between 2007 to 2014, and 320 percent between 2010 to 2014. Market concentration in smartphones, as measured by HHIs, went from “highly concentrated” in 2007, as defined by the U.S. Antitrust Agencies’ Horizontal Merger Guidelines, to “unconcentrated” by the end

potentially disrupting the carefully balanced fair, reasonable, and non-discriminatory (FRAND) ecosystem that has emerged organically.

With respect to the three specific areas identified in the Communication (i.e., best practice recommendations on (1) “increased transparency on SEP exposure,” including “more precision and rigour into the essentiality declaration system in particular for critical standards”; (2) “boundaries of FRAND and core valuation principles; and (3) “enforcement in areas such as mutual obligations in licensing negotiations before recourse to injunctive relief, portfolio licensing[,] and the role of alternative dispute resolution mechanisms), the EC should broaden the scope of its consultation to elicit specific evidence of identifiable market imperfections.¹⁷

In some cases, specific concerns mentioned in the consultation seem to be contradicted by the EC’s own published research. For example, with respect to the asserted problems arising from over-declaration of essential patents, the EC recently published research noting the lack of “any reliable evidence that licensing costs increase significantly if SEP owners over-declare,” and concluding “that, per se the negative impact of over-declaration is likely to be minimal.”¹⁸ Even assuming there is an identifiable market imperfection in this area, it is important to consider that determining essentiality is a resource and time-intensive exercise and there are likely significant transaction-cost savings from the use of blanket declarations, which also serve to avoid liability for patent-ambush (i.e., deceptive failure to disclose essential patents during the standard-setting process).¹⁹

Conclusion

of 2012. See Keith Mallinson, *Theories of Harm with SEP Licensing Do Not Stack Up*, IP FIN. BLOG (May 24, 2013), <http://ipfinance.blogspot.com/2013/05/theories-of-harm-with-sep-licensing-do.html>. According to the U.S. Bureau of Labor Statistics, the ratio of the CPI for wireless telephone services to the overall CPI has dropped 34% from 2007 to 2014. More generally, prices in SEP-reliant industries in the United States have declined faster than prices in non-SEP intensive industries. Alexander Galetovic, Stephen Haber, & Ross Levine, *An Empirical Examination of Patent Hold-Up* (Nat’l Bureau of Econ. Research, Working Paper No. 21090, Apr. 2015), <http://www.nber.org/papers/w21090.pdf>.

¹⁷ Although the EC’s March 25, 2014 report, entitled *Patents and Standards: A modern framework for IPR-based standardization* (EC 2014 Report), identifies *possible* “market failures” in the form of asymmetric information and market power (see Section 2.1 at pages 25-27), it does not provide evidence of any actual market failure.

¹⁸ PIERRE RÉGIBEAU, RAPHAËL DE CONINCK, & HANS ZENGER, *STUDY ON TRANSPARENCY, PREDICTABILITY AND EFFICIENCY OF SSO-BASED STANDARDIZATION AND SEP LICENSING* 62 (European Comm’n 2016) (“A first possibility is that a baseless inflation in the number of declared SEPs simply increases the costs of reaching a licensing agreement. However, the direct impact of the number of SEPs on negotiation costs is not all that clear. For example, if negotiations mostly involve “counting” the patents in the various SEP portfolios to determine the share of total royalties that the owners of these portfolios are entitled to, there would be little reason for licensing costs to increase sharply if at all with the number of declared SEPs. In the same vein, if negotiations mostly involve looking at the licensors’ “jewels”, then the number of these jewels is not affected by including non-essential patents in the portfolio and, hence the costs of negotiations should not be much affected by SEP inflation.”), http://ec.europa.eu/growth/industry/intellectual-property/patents/standards_en.

¹⁹ The EC’s 2014 Report points to the 2011-2013 litigation in the United States and Europe between Motorola and Microsoft as illustrative of “transparency problems as a result of blanket declarations,” stating that blanket declarations “hampered the ability of the [U.S. district] court to have a good understanding of the total existence and ownership of SEPs for the standards in dispute” (see Section 4.2.2 at page 117). However, as the Federal Circuit subsequently explained in *Ericsson v. D-Link*, the burden is on the implementer to provide evidence establishing the actual cumulative royalty, and that royalty must be evaluated to determine whether it is excessive. 773 F.3d at 1234. The court of appeals in *Microsoft v. Motorola* rejected the approach taken by the U.S. district court of considering the aggregate royalties that would apply if one assumed that all SEP holders charged the same or similar rates. The problem with that approach is that not all patents are of equal value and FRAND rates should reflect the value of the particular SEPs at issue. In addition, many licensees do not pay cash royalties for every SEP. Instead, there may be cross-licenses or other business relationships that allow for royalty-free exploitation of some SEPs.

In summary, the EC should reconsider its proposed approach of issuing best practice recommendations for SDOs and seeking to achieve “better regulation” of standard-setting activities. Instead, it should embrace the procompetitive benefits of variation among SDO policies, thereby avoiding one-size fits all recommendations that may interfere with or unduly influence choices regarding specific rules that best fit the needs of individual SDOs and their members. Finally, prior to recommending regulation, it should broaden the scope of its consultation to elicit specific evidence of identifiable market imperfections, which are a necessary, but not sufficient condition to economic regulation.